

**WASHINGTON STATE INVESTMENT BOARD**  
**Board Meeting Minutes**  
**December 18-19, 2014**

The Washington State Investment Board met in open session at 9:32 a.m. in the boardroom at 2100 Evergreen Park Drive SW, Olympia, Washington.

Present: Marcie Frost, Chair  
Kelly Fox, Vice Chair  
Arlista Holman  
Judy Kuschel  
Bill Longbrake  
George Masten  
Treasurer Jim McIntire  
Stephen Miller  
Richard Muhlebach  
Bob Nakahara  
Representative Timm Ormsby  
David Nierenberg  
Joel Sacks  
Jeff Seely

Absent: Senator Sharon Nelson

Also Present: Theresa Whitmarsh, Executive Director  
Gary Bruebaker, Chief Investment Officer  
Victor Moore, Chief Operating Officer  
Liz Mendizabal, Institutional Relations Director  
Steve Draper, Senior Investment Officer – Real Estate  
Bill Kennett, Senior Investment Officer – Fixed Income  
Phil Paroian, Senior Investment Officer – Public Equity  
Tom Ruggels, Senior Investment Officer – Private Equity  
Allyson Tucker, Senior Investment Officer – Risk Management  
and Asset Allocation  
Diana Will, Senior Investment Officer – Tangibles  
Rhonda McNavish, Assistant Senior Investment Officer – Public  
Equity  
Fletcher Wilson, Investment Officer – Public Equity  
Kristi Haines, Confidential Secretary  
Stacy Conway, Administrative Assistant – Investments  
Linda Buchanan, Administrative Assistant – Private Equity  
  
Mary Lobdell, Attorney General's Office  
Michael Augustine, Hamilton Lane  
Tara Blackburn, Hamilton Lane  
Natalie Fitch, Hamilton Lane  
Mario Giannini, Hamilton Lane

[Names of other individuals attending the meeting are listed in the permanent record.]

Chair Frost called the meeting to order and took roll call.

### **ADOPTION OF THE NOVEMBER 20, 2014, MEETING MINUTES**

**Ms. Holman moved to adopt the November 20, 2014, meeting minutes. Treasurer McIntire seconded, and the motion carried unanimously.**

### **PUBLIC COMMENT**

There was no public comment.

### **EXECUTIVE DIRECTOR'S REPORT**

Ms. Whitmarsh reported the Private Markets Committee will meet on January 8, and the January 6 Public Markets Committee was cancelled. The Administrative Committee and Board will both meet on January 15. Ms. Whitmarsh said she presented to the Select Committee on Pension Policy yesterday, addressing questions focused around volatility within private markets. In terms of Board governance, Ms. Whitmarsh announced that Senator Nelson's term ends at the end of this year, and she will not seek reappointment. The Senate Majority Leader has submitted a request to the Lieutenant Governor for a new appointee and staff is awaiting an announcement, which will then be communicated to the Board.

### **ASSISTANT ATTORNEY GENERAL'S REPORT**

Ms. Lobdell reported the WSIB was served with a complaint involving Seaport Village, which is a continuation of litigation from California from about 2-3 years ago. The WSIB was dismissed from the California matter. The plaintiff subsequently filed another complaint in Delaware court and recently filed a fourth amended complaint naming the WSIB as a defendant along with Calzada Capital Partners, LLC.

### **PRIVATE MARKETS COMMITTEE REPORT**

Mr. Masten reported the Private Markets Committee met on December 4 to consider two private equity and two real estate investment recommendations. He said the Committee was unable to take action at its meeting as there were only two voting members present; therefore, the investment recommendations are referred to the Board for approval by consensus.

### **KSL Capital Partners IV, L.P.**

**Mr. Masten moved that the Board invest up to \$250 million, plus fees and expenses, in KSL Capital Partners IV, L.P., subject to continuing due diligence and final negotiation of terms and conditions.**

Mr. Masten said the fund will continue KSL's proven niche strategy to pursue acquisitions of under-managed and/or under-capitalized businesses in the hospitality, recreation, clubs, real estate, and travel services sectors. The WSIB has invested in the three prior KSL funds. The proposed investment is consistent with the updated 2014 private equity annual plan and model portfolio. He said the recommendation is based on KSL's large,

experienced team; strong performance with substantial realizations; proven, focused niche strategy; fit in the WSIB's private equity portfolio; and other factors relevant to the recommendation.

**Vice Chair Fox seconded, and the above motion carried unanimously.**

#### **Endeavour Capital Fund VII, L.P.**

**Mr. Masten moved that the Board invest up to \$150 million, plus fees and expenses, in Endeavour Capital Fund VII, L.P., subject to continuing due diligence and final negotiation of terms and conditions.**

Mr. Masten said the fund will invest in management buyout, growth equity, and recapitalization transactions in the lower middle market in the Western United States. The WSIB has invested in three prior Endeavour equity funds, as well as in the Endeavour Structured Equity and Mezzanine Fund. The proposed investment is consistent with the updated 2014 private equity annual plan and model portfolio. He said the recommendation is based on the stable, experienced investment team; strong, consistent performance; successful, regionally-focused investment strategy; fit in the WSIB's private equity portfolio; and other factors relevant to the recommendation. Mr. Nierenberg recused himself from any discussion of the recommendation due to a conflict of interest.

**Vice Chair Fox seconded, and the above motion carried unanimously.**

#### **Evergreen Real Estate Partners LLC**

**Mr. Masten moved that the Board invest an additional \$500 million, plus fees and expenses, in Evergreen Real Estate Partners LLC, subject to continuing due diligence and final negotiation of terms and conditions. Mr. Fox seconded the motion.**

Mr. Masten reported that, as a WSIB real estate intermediary, Evergreen will invest in real estate operating companies (REOCs), consistent with the WSIB's primary strategy for real estate investments. To date, the Partnership has invested in 13 companies, committing all \$3.0 billion of its available equity, thus necessitating this recommendation. He said the recommendation is based on the quality of the firm's senior management and depth of their team; global connections; quality of management and growth potential of the REOCs they own; the strength of their underwriting and oversight of REOCs; history of strong returns; strong governance rights; exclusivity; and fit in the WSIB's real estate portfolio.

**The above motion carried unanimously.**

## **Calzada Capital Partners, LLC**

**Mr. Masten moved that the Board invest an additional \$600 million, plus fees and expenses, in Calzada Capital Partners, LLC, subject to continuing due diligence and final negotiation of terms and conditions. Mr. Fox seconded the motion.**

Mr. Masten said the partnership's strategy is to invest in or with REOCs, consistent with the WSIB's primary strategy for real estate investment. The WSIB transferred four directly-owned real estate operating companies (REOCs) to Calzada upon its creation in 2013 and provided an additional \$250 million commitment for new transactions.

Including the transferred entities, the total existing commitment to the partnership to date is \$2.725 billion. Calzada has allocated all of the funds committed to them by the WSIB, necessitating this recommendation. He said the recommendation is based on the quality of leadership and track record of Calzada's leadership; ability and skillset of the team; quality of the investment potential for both existing and future REOCs; strong governance rights; exclusivity; and fit in the WSIB's real estate portfolio.

**The above motion carried unanimously.**

### **PUBLIC MARKETS COMMITTEE REPORT**

Mr. Sacks reported the Public Markets Committee met on December 2 for an educational session on the Public Equity program. Mr. Paroian explained how the WSIB program compares with its peers; the program structure and investment beliefs, including reasons for considering external active managers; how public equity uses consultants; the difference between the focus of public markets and that of private markets; the menu of options for defined contribution; what the staff is responsible for; the prioritization of responsibilities; and considerations in choosing external managers. An opportunity was provided for participants to ask questions and provide suggestions for future education topics. Mr. Sacks encouraged that other committees consider holding education sessions when possible. Ms. Whitmarsh said a robust education calendar will be proposed for the Committees this year.

### **AUDIT COMMITTEE REPORT**

Treasurer McIntire reported the Audit Committee met on December 2 and reviewed Peterson Sullivan's audit of the Fiscal Year 2014 Independent Financial Auditors' Reports, which included the Retirement Funds, Labor and Industries' Funds, Permanent Funds, Guaranteed Education Tuition Fund (GET), and Developmental Disabilities Endowment Trust Fund (DDEF). All reports concluded the statements were presented fairly, with no material misstatements identified. Treasurer McIntire explained the reports are a part of the WSIB's annual report, which the Board must approve.

**Treasurer McIntire moved that the Board approve the Fiscal Year 2014 Independent Financial Auditors' Report. Mr. Masten seconded, and the motion carried unanimously.**

**Treasurer McIntire moved that the Board approve the 2014 Annual Report in its entirety. Mr. Masten seconded, and the motion carried unanimously.**

Treasurer McIntire continued his report, noting the Committee met privately with the independent financial statement auditors in executive session. It also received updates on the status of prior audit recommendations and audit plan, and quarterly investment referrals.

## **POLICY ITEMS**

### **Guaranteed Education Tuition (GET) Program Strategic Asset Allocation Recommendation and Policy 2.35.100 Revision**

Ms. Tucker presented the GET Program strategic asset allocation recommendation and proposed policy change. She said the GET program was enacted by the Legislature in the late 1990s and the WSIB is responsible for investing its assets, which currently total around \$2.6 billion. She noted the State Actuary's presentation at last month's Board meeting, which included an overview and background of the GET program; its price setting process; funded status, key assumptions, and experience; assets; and risk analysis. Ms. Tucker prepared a brief memo to the Board covering the asset allocation thinking, process, and other details.

Ms. Tucker highlighted the stress brought on by negative returns during the economic downturn and double impact from the strongly increasing tuition growth at higher education institutions at that time, which hurt the GET program's funding status and resulted in price setting alterations. Markets have since rebounded and tuition growth leveled off, resulting in a healthier funded status, which is at 106 percent as of the last measurement.

For purposes of this asset allocation recommendation, Ms. Tucker said staff engaged with the Office of the State Actuary (OSA) and used its risk models to evaluate alternative asset allocation scenarios, which highlight the tradeoff between solvency and affordability for the GET program. She said there are four key elements to the recommended asset allocation: 1) eliminate the Treasury Inflation Protected Securities (TIPS) allocation, and collapse it into the broader fixed income category, 2) the first recommendation then increases the total fixed income allocation from 20 to 40 percent, 3) decrease the real return performance benchmark to a real 3.25 from 4.5 percent to be more consistent with the expectation of the investment profile, and 4) increase the cycle time for formal asset allocation review from three to four years.

Staff proposes the Board approve both the proposed asset allocation and policy changes.

**Chair Frost moved that the Board approve the recommended strategic asset allocation for the Guaranteed Education Tuition program and adopt the proposed revisions to the Advanced College Tuition Payment Program Policy 2.35.100. Treasurer McIntire seconded, and the motion carried unanimously.**

### **Developmental Disabilities Endowment Trust Fund (DDEF) Strategic Asset Allocation Recommendation and Policy 2.35.400 Revision**

Ms. Addo provided an overview of the DDEF program and presented the proposed asset allocation recommendation. She said that DDEF was created by the Legislature in 1999 to provide an avenue for people with disabilities to invest for the future and be educated on how to financially plan. She reviewed the program requirements and said the funds are to be used for any life enhancing needs that are not funded by the government and cannot be used for living expenses. There are currently 2,000 participants. She described the governing body and the two accounts DDEF funds are held within, which include a state account for state-matched funds from the Legislature, and a private account with contributions from beneficiaries, their families, and friends. The split as of September 30, 2014, was 3:1 for private and state, respectively.

Ms. Addo said DDEF fund performance is in line with expectations. She detailed the current state fund and private account asset allocation mixes. WSIB staff engaged in discussions with the DDEF staff and board regarding their risk tolerance, return objectives, and cash management trends and requirements. DDEF agreed there had been no changes to WSIB's staff key assumptions. WSIB staff's proposed asset allocation was as follows; for the state fund: 1) eliminate the TIPS allocation and move it to fixed income, 2) transfer the U.S. and non-U.S. equity to global equity, and 3) change the asset allocation cycle from three to four years. The state fund asset allocation targets would become fixed income at 83 percent with a range of +/- 3 percent; global equity at 17 percent with a range of + or - 3 percent; and cash at 0 percent with a range of + 5 percent. Further, the private fund recommendation is to leave it unchanged at a 60/40 equity and fixed income split, respectively.

**Chair Frost moved that the Board approve the recommended strategic asset allocation for the Developmental Disabilities Endowment Trust Fund and adopt the proposed revisions to the Policy 2.35.400. Mr. Masten seconded, and the motion carried unanimously.**

### **Higher Education Supplemental Retirement Fund Policy 2.35.600 Adoption**

Ms. Tucker presented a newly created investment policy for the Higher Education Supplemental Retirement Fund (Higher Ed Fund). The fund is a closed defined benefit (DB) plan currently sponsored by the higher education institutions. It is a supplemental plan in that DB becomes available to participants in addition to defined contribution (DC) plan benefits under certain qualifying conditions.

Ms. Tucker said legislation was enacted in 2011 that limited the authority of the administrators and required employer contributions into the fund. The legislation named the WSIB as investment manager. The current funding process is that employers make regular contributions to the fund. The Department of Retirement Systems (DRS) collects those funds and sends them to WSIB for investment. Benefits are not currently being paid out of the funds.

The OSA has committed to valuing the associated liabilities and will also provide cash flow projections as part of that process. The actuarial work is slated to conclude in 2016. Once liabilities and projected cash flows are identified by the OSA, staff can perform an

asset allocation study. Until then, funds will be invested in cash. She said that Higher Ed fund assets currently total \$25.7 million.

In response to Board member questions, Ms. Whitmarsh said she did not believe staff could provide any further clarity to what WSIB will do with the fund until it gets further information on its liabilities, cash flow, and other decisions are made.

**Chair Frost moved that the Board adopt the Higher Education Supplemental Retirement Fund Policy 2.35.600. Vice Chair Fox seconded, and the motion carried unanimously.**

[Mr. Miller left at 10:15 a.m.]

## **ANNUAL PLAN DISCUSSIONS**

### **2015 Public Equity Annual Plan Discussion**

Mr. Paroian, Ms. McNavish, and Mr. Wilson presented the 2015 public equity annual plan. Mr. Paroian provided an overview of the purpose of the annual plan. He shared that David Thatcher, public equity investment officer, will retire at the end of the year and thanked him for his hard work and years of service.

Mr. Paroian reviewed the key equity investment principals, including the mission of the WSIB to maximize returns at a prudent level of risk. Public equity is mostly passive and utilizes active management only with people with whom there is a very high conviction. He explained that public equity markets are becoming increasingly global, emerging markets are becoming more important, and downside protection is important.

Ms. McNavish explained public equity's responsibilities, including manager monitoring, rebids and renewals, enhancements to existing programs, research, and one-off standalone requests. Mr. Wilson shared a breakdown of public equity's assets under management.

Mr. Paroian discussed the Commingled Trust Fund (CTF) allocation, explaining the public equity allocation must remain liquid, as WSIB has a significant level of illiquid investments in private markets, and said passive management is the preferred approach to get broad inexpensive equity market exposure. He reiterated that public equity only goes after active management when it is believed a manager can do better than passive management.

Ms. McNavish discussed the public equity investment strategies and breakdown of assets under management in the CTF, and Mr. Wilson shared the breakdown of public equity defined contribution (DC) assets under management. Mr. Paroian discussed the menu of products offered in DC and discussed the behavioral research behind the current menu design. Mr. Fox asked how long the WSIB has been managing DC programs and how they have grown over what time frame. Mr. Paroian responded that the Plan 3 hybrid began in 1997 and the Deferred Compensation Program in 1981, and he indicated he would send Mr. Fox the AUM history broken down by plan. Mr. Masten said that when DC started, there were very few options.

Mr. Paroian discussed the decision-making process for adding funds. He said there has to be good reason to add new options, sharing that the DRS Advisory Committee is very comfortable with this approach. Mr. Sacks asked if it would be the expectation that over five years' time the breakdown in AUM would reflect a decrease in the Total Allocation Portfolio participant total and an increase in the retirement strategy total. Mr. Paroian responded in the affirmative. Mr. Sacks asked if there was a point at which fees become so high that a particular menu option might be discontinued. Mr. Paroian responded that if participation were to drop, it would be necessary to look at the structure and feasibility of the option. Ms. Holman asked for clarification that these menu options are available for individuals to choose, and Mr. Paroian confirmed.

Messrs. Paroian and Wilson and Ms. McNavish discussed the needs, mandates, investment structure, and management for the various funds for which public equity invests.

[The Board recessed at 10:47 a.m., and reconvened in open session at 11:02 a.m.]

Mr. Paroian discussed the public equity returns as of the end of November, which are positive over one-year, three-year, five-year, and seven-year rolling periods.

Ms. Kuschel asked what the differences are for passive, fundamental, and quant returns. Mr. Paroian responded the answer to her question would be coming up shortly in the presentation and further addressed at the February 2015 Board meeting. Messrs. Paroian and Wilson and Ms. McNavish discussed the initiatives and accomplishments for 2014.

Mr. Masten asked if public equity research includes the following of nanosecond traders. Mr. Paroian responded the team tries to stay up to date with high frequency trading and utilizes a third party service, Zeno, to look at all trades. He said the subject will be discussed in more detail at the March Audit Committee meeting.

Mr. Paroian shared that planning leads up to annual plan

Mr. Paroian and Ms. McNavish shared the proposed 2015 initiatives, including existing manager monitoring and further development of risk management tools and processes;; rebids and renewals, including completion of the emerging markets search; renewal of Aberdeen and Mondrian emerging market contracts; assisting with DRS record-keeper implementation; enhancements to the existing active global, active emerging markets, passive, and DC programs, including discussions with the Board Chair and DRS Director about future DC education sessions; and global, DC, and passive-versus-active management research.

Mr. Paroian discussed the public equity plan relating to implementation of the global climate risk investment belief and addressing these risks with external managers. Treasurer McIntire asked if it would be possible to do a roll-up of the footprint for the entire passive portfolio that could be reviewed on an annual basis to see how it changes over time. Mr. Paroian responded in the affirmative. Mr. Sacks asked about the best way for the Board to be informed about the climate risk conversation. Mr. Paroian responded that it is yet to be determined how the information will be reported to the

Board. Mr. Bruebaker said that information will be developed and communicated during each year's annual plan and July annual plan update.

Mr. Masten asked if the drop in oil price and New York outlawing fracking is impacting public equity. Mr. Paroian responded that in the short term, yes; as the WSIB is market weight in passive investments, there are some energy holdings. He said active managers are split, and the question of where we are in the commodities cycle is a question debated internally. A key question is how much is discounted in price already.

Mr. Masten asked for the breakdown on returns. Mr. Paroian said detail will be provided in February 2015, when the December 31, 2014, information is available, and he discussed general returns to date and progress of the investments.

Mr. Longbrake asked if value could be added to the public equity program with more resources and what are the obstacles to adding staff. Mr. Paroian said the open position will be posted in January, and there is a request in the 2015-17 budget for an additional person. He said that more people could bring value to the program, but it is important to be careful of growing too quickly.

Chair Frost asked if the additional detail regarding the products that could be added into the target date funds would be shared with the Public Markets Committee next year. Mr. Paroian responded that he was planning to have a discussion with the head of DRS and the Board chair regarding options to, and educational sessions around, the target date funds.

Chair Frost congratulated the team and Mr. Paroian on the public equity performance.

**Mr. Sacks moved that the Board adopt the 2015 Public Equity Annual Plan. Mr. Fox seconded, and the motion carried unanimously.**

[The Board recessed at 11:55 a.m., and reconvened in open session at 12:23 p.m.]  
[Mr. Miller returned at 12:23 p.m.]

### **EXECUTIVE SESSION**

Chair Frost announced the Board would go into executive session to discuss financial and commercial information relating to an investment, since public knowledge regarding the discussion would result in loss to the funds managed by the WSIB or would result in private loss to the providers of the information. She said the executive session was expected to last until at least 4:00 p.m., at which time the Board would reconvene in open session to take a vote on the items discussed in executive session, and then recess. Further, she said the Board will go back into executive session at the beginning of its meeting tomorrow and remain in executive session until it reconvenes into open session to vote on the final agenda item, and then adjourn.

[The Board went into executive session at 12:23 p.m.]

### **Tangible Assets Annual Plan Discussion**

[The Board recessed at 2:10 p.m., and reconvened in executive session at 2:24 p.m.]

[Mr. Seely left at 3:07 p.m.]

### **Real Estate Annual Plan Discussion**

[Chair Frost noted the executive session would extend beyond 4:00 p.m.]

[The Board reconvened in open session at 4:55 p.m.]

**Chair Frost moved that the Board adopt the 2015 Tangible Assets Annual Plan that was presented and discussed in executive session. Vice Chair Fox seconded, and the motion carried unanimously.**

**Chair Frost moved that the Board adopt the 2015 Real Estate Annual Plan that was presented and discussed in executive session. Vice Chair Fox seconded, and the motion carried unanimously.**

[The Board recessed at 4:56 p.m., and reconvened in open session at 6:15 p.m.]

### **DINNER PRESENTATION**

Mr. Giannini presented Hamilton Lane's private markets outlook and reviewed past performance of and trends within the industry.

[The Board recessed at 7:00 p.m. on December 18.]

### **December 19**

[The Board reconvened on December 19 in open session at 9:33 a.m.]

[Mr. Nakahara was in attendance.]

Chair Frost called the meeting to order and took roll call.

Chair Frost announced the Board would go into executive session to discuss financial and commercial information relating to an investment, since public knowledge regarding the discussion would result in loss to the funds managed by the WSIB or would result in private loss to the providers of the information. She said the executive session was expected to last until at least 11:00 a.m., at which time the Board would reconvene in open session to vote on the final agenda item, discuss any other miscellaneous items, and then adjourn.

[The Board went into executive session at 9:34 a.m.]

### **ANNUAL PLAN DISCUSSIONS** **2015 Private Equity Annual Plan Discussion**

[Mr. Sacks arrived at 9:46 a.m.]

[Treasurer McIntire arrived at 10:06 a.m.]

[The Board recessed at 11:10 a.m., and reconvened in executive session at 11:21 a.m.]

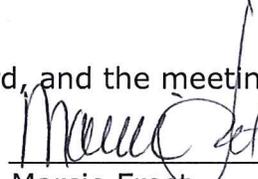
[Chair Frost announced the executive session would be extended until approximately 12:00 p.m., and made a subsequent announcement the session would extend until approximately 12:30 p.m.]

[The Board reconvened in open session at 12:52 p.m.]

**Chair Frost moved that the Board adopt the 2015 Private Equity Annual Plan that was presented and discussed in executive session. Mr. Masten seconded, and the motion carried unanimously.**

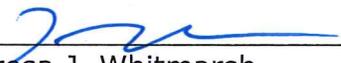
**OTHER ITEMS**

There was no further business to come before the Board, and the meeting adjourned at 12:54 p.m.

  
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Marcie Frost  
Board Chair

11/15/15

ATTEST

  
\_\_\_\_\_  
Theresa J. Whitmarsh  
Executive Director

